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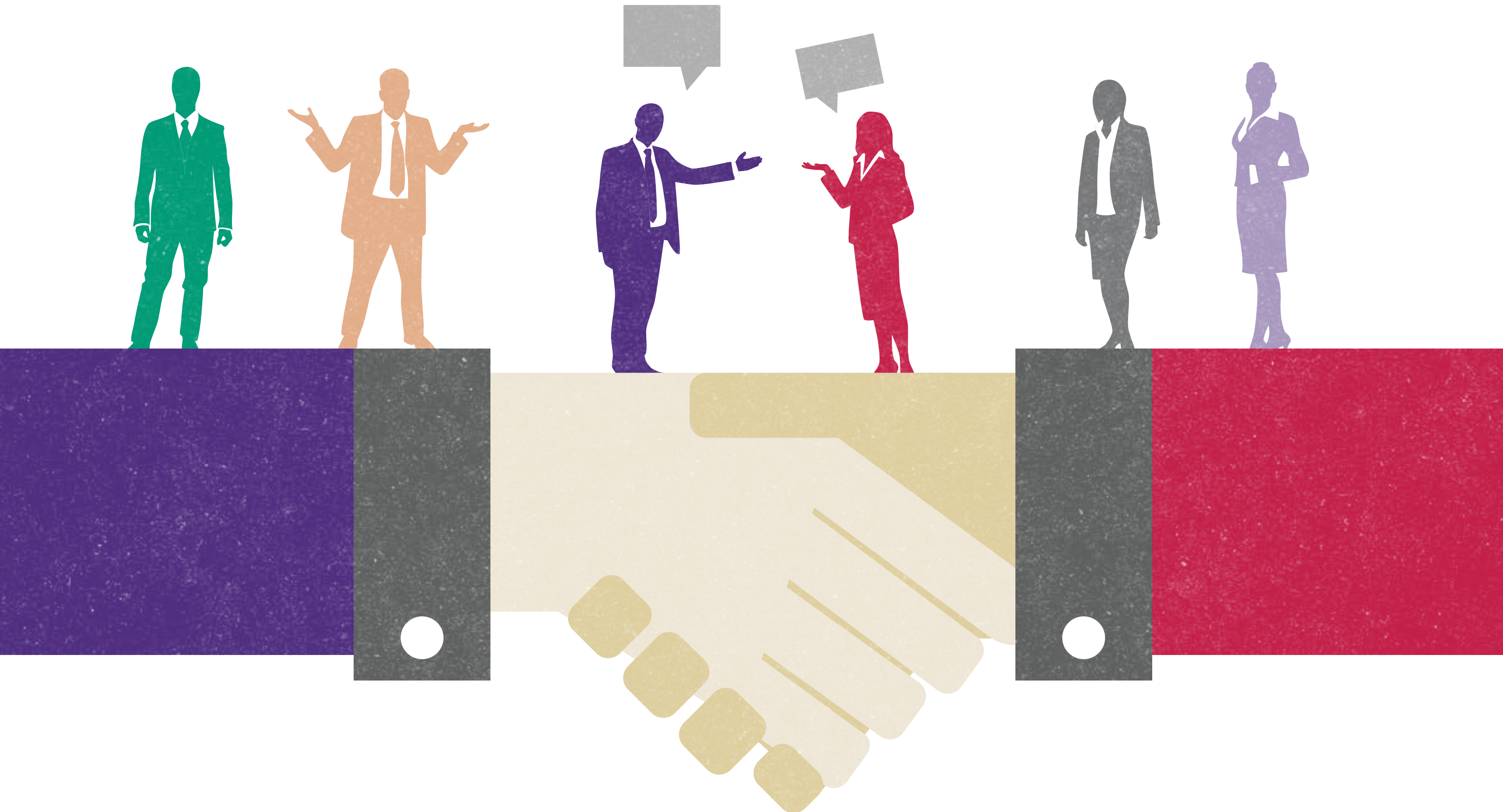
Comparing Indian GAAP and Ind AS - Valuation perspective



Introduction

Indian corporates are in the process of transitioning to a new set of accounting standards called the Indian Accounting Standards (Ind AS) which converge closely with the International Financial Reporting Standards (IFRS). Adoption of IFRS by Indian corporates will be challenging but at the same time will be rewarding as well, since it is likely to result in improved comparability, transparency and quality of financial statements. There are several fundamental changes that the new standards will bring when compared to the antiquated Indian Accounting Standards (IGAAP). One key fundamental change is the significant increase in focus on fair value accounting. Ind AS requires application of fair value principles, which would result in significant differences from financial information being presented currently. Complying with fair value principles of Ind AS will require assistance from specialist professionals with valuation skills to arrive at reliable fair value estimates.

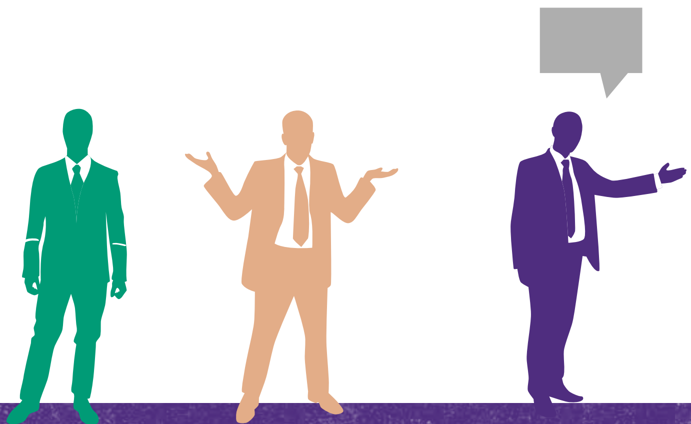
Also, management and professionals involved in the preparation of financial statements will have to hone their valuation skills. With increased scrutiny from regulators and investors, management and auditors will have to ensure that fair valuation of assets and liabilities is not only technically correct and supportable but also complies with principles of Ind AS.

Standards such as Ind AS 113 - Fair Value Measurement, Ind AS 103 – Business Combinations, Ind AS 38 - Intangible Assets, Ind AS 16 - Property, Plant and Equipment, Ind AS 40 – Investment Property, Ind AS 36 – Impairment of Assets, Ind AS 102 – Share-based Payment and Ind AS 109 - Financial Instruments look to establish a framework for measurement of assets and liabilities for financial reporting purposes, using fair value as their guiding principle. A brief comparison of these standards with IGAAP from valuation perspective is presented below:

	IGAAP	Ind AS	Remarks
FAIR VALUE MEASUREMENT			
	No framework for measuring fair value	**Ind AS 113 - Fair Value Measurement**	
	There is no framework for measuring fair value for financial reporting.	Establishes a single framework for measuring fair value for financial reporting. Ind AS provides guidance on - valuation techniques, inputs to valuation techniques (i.e. fair value hierarchy), concepts such as highest and best use, most advantageous market and principal market and fair value disclosures.	The fact that there is a standard entirely dedicated for measuring fair value for financial reporting purposes, is indicative of the importance of fair valuation of assets and liabilities under Ind AS. Compliance with Ind AS 113 would entail an understanding and application of complex and advanced valuation techniques.
	Fair value may be entity-specific and not market-based. For e.g. as per AS 14, determination of fair values may be influenced by the intentions of the transferee company.	Unlike IGAAP, fair value is a market based measurement under Ind AS i.e. it is measured using the assumptions that market participants would use when pricing the asset or liability, including assumptions about risk. As a result, an entity's intention to hold an asset or to settle or otherwise fulfil a liability is not relevant when measuring fair value.	

	IGAAP	Ind AS	Remarks
BUSINESS COMBINATION			
	AS 14 – Accounting for Amalgamations	**Ind AS 103 – Business Combinations / Ind AS 38 - Intangible Assets**	
Scope	The transactions that meet the definition of amalgamations under the Companies Act are accounted for in compliance with AS 14. An acquisition can be accounted as amalgamation in the nature of purchase or amalgamations in the nature of merger. The accounting treatment of an acquisition depends upon the structure of the acquisition. Goodwill arises, only if an amalgamation is in the nature of purchase.	Under Ind AS 103, if an acquirer obtains control of a 'business' then the acquisition will be accounted as a business combination. The term 'business' is defined under Ind AS. Hence, Ind AS 103 will be applicable and Goodwill will be recognised if a 'business' is acquired irrespective of the legal structure of an acquisition.	Under IGAAP, accounting treatment of an acquisition varies significantly depending on its legal structure, which also impacts the reported amount of goodwill. Under Ind AS, it will not be relevant whether an acquisition is of a legal entity or a group of assets as long as acquired assets / entity meets the definition of a business except common control. The intangibles will have to be identified and recognised at fair value separately from goodwill and will get amortised over their estimated useful economic life which will impact the profit and loss statement going forward. Hence, organisations will have to consider accounting implications of Ind AS 103 in each phase of the acquisition and involve independent experts to avoid any accounting hurdle subsequently.
Goodwill measurement / Purchase Price Allocation	In case of an amalgamation in the nature of purchase, difference between the consideration and the value of the net assets acquired is recognised as Goodwill (if the difference is positive) or Capital Reserve (if the difference is negative). Hence, only assets and liabilities reflected in the books of the acquiree and acquired by acquirer will be considered while arriving at the Goodwill.	Goodwill is the difference between the fair value of the consideration and fair values of the identifiable assets (tangible and intangible) and liabilities as of the acquisition date. Hence, assets or liabilities even if not appearing in the books of the acquiree and which can be identified will be considered at fair values for arriving at the goodwill. Some commonly identifiable intangibles in purchase price allocation include customer contracts, customer relationships, brand and technology.	
Subsequent measurement of goodwill	Goodwill arising on amalgamation is to be amortised over a period not exceeding five years unless a somewhat longer period can be justified.	Goodwill arising on business combination is to be tested for impairment annually. (Ind AS 36)	

	IGAAP	Ind AS	Remarks
PROPERTY, PLANT and EQUIPMENT (PPE)			
	AS 10 - Accounting for Fixed Assets	**Ind AS 16 - Property, Plant and Equipment**	
Revaluations	Revaluation is permitted, however, there is no specific requirement on frequency of revaluation.	Companies will have to opt for either of the two accounting models viz. Cost model or Revaluation model permitted by the Ind AS 16 on the date of transition. Subsequently under Revaluation Model, PPE are revalued at fair value periodically, so that the carrying amount of an asset does not differ materially from its fair value at the balance sheet date. Revaluations do not affect the income statement, but rather are recognised in equity, unless the revaluation decreases an asset value below its net book value.	On first time adoption of Ind AS, companies will have an option to recognise PPE at cost (defined under Ind AS) or at fair value (which will be consider as deemed cost). If a company opts for the later, the difference will be credited to equity and not revaluation reserve. Hence, opting for fair valuation PPE on first time adoption will benefit asset-heavy companies as an upward valuation will increase their equity. Subsequent to the initial recognition, companies can opt for either of the two accounting models: Cost model and Revaluation model. Accordingly, revaluation model, impairment testing, purchase price allocation and componentization under Ind AS will require assistance from technical experts in estimating obsolescence from physical, technological, functional and economic factors and carrying out fair valuation of PPE.
	Component accounting is permitted but is rarely followed in practice.	Under Ind AS 16, component approach is to be followed for accounting for PPE. Under componentisation, if a fixed asset has two or more major components with substantially different useful lives, then the components should be treated as separate assets and be depreciated over their respective useful lives which will ensure that the income and expenditure statement correctly reflects the consumption of economic benefits inherent in those assets.	
INVESTMENT PROPERTY			
	AS 13 - Accounting for Investments	**Ind AS 40 – Investment Property**	
Initial and subsequent measurement	Investment property initially recognised at cost. Subsequently, it is measured at cost less accumulated depreciation less other-than-temporary impairment loss, if any.	Similar to IGAAP except an entity is required to disclose the fair value of its investment property.	Accordingly, fair valuation and impairment test of investment property under Ind AS will require assistance from valuation specialists.



	IGAAP	Ind AS	Remarks
		IMPAIRMENT OF ASSETS	
	AS 28 – Impairment of Assets	**Ind AS 36 – Impairment of Assets / Ind AS 38 - Intangible Assets**	
Applicability	Applies to all assets except inventories, assets arising from construction contracts, deferred tax assets, assets arising from employee benefits, financial assets and investments.	Applies to all assets except inventories, assets arising from construction contracts, deferred tax assets, assets arising from employee benefits and financial assets that are within the scope of Ind AS 39. Applies to financial assets classified as subsidiaries, associates and joint ventures.	Unlike IGAAP, where goodwill is tested for impairment only where there is an indication of impairment, Ind AS requires goodwill be tested annually for impairment even if there is no indication of impairment. Like IGAAP, compliance with Ind AS will continue to require assistance of valuation experts to carry out valuation of intangible and tangible assets to test for their impairment testing.
Frequency of impairment testing	An entity should test the assets or a cash generating unit for impairment at the end of each reporting period if the impairment indicators exist. However, an entity should test the following assets for impairment annually irrespective of whether the impairment indicators exists or not - an intangible asset not yet available for use; and - an intangible asset with an estimated useful life of more than ten years.	Similar to IGAAP. However, an entity should test the following assets for impairment annually irrespective of whether the impairment indicators exists or not: - an intangible asset not yet available for use; - an intangible asset with an indefinite useful life; and - goodwill acquired in a business combination	
		SHARE BASED PAYMENTS	
	Guidance Note by the ICAI and SEBI guidelines	**Ind AS 102 – Share-based Payment**	
Measurement	Option to measure based on the grant date fair value or intrinsic value of the equity instruments issued.	Measured based on the grant-date fair value of the equity instruments issued.	Ind AS requires calculation of the fair value of the options as against the intrinsic value method under IGAAP. While this could be easy for simple ESOPs, the fair valuation can become extremely complex for more advanced stock option plans involving market linked vesting. Compliance with Ind AS will require determination of fair valuation of such ESOPs using complex options pricing models which will require assistance from experts.

<table>
<tr><th></th><th>IGAAP</th><th>Ind AS</th><th>Remarks</th></tr>
<tr><td colspan="4">FINANCIAL INSTRUMENTS</td></tr>
<tr><td></td><td>AS 13 – Accounting for Investments

AS 30 – Financial Instruments: Recognition and Measurement is currently not mandatory</td><td>Ind AS 36 – Impairment of Assets / Ind AS 38 - Intangible Assets

Ind AS 109 on Financial Instruments will replace Ind AS 39 Financial Instruments: Recognition and Measurement</td><td></td></tr>
<tr><td>Initial Measurement</td><td>AS 13 contains limited guidance dealing with long term and short term investments under IGAAP</td><td>All financial instruments are initially measured at fair value plus or minus transaction costs except Fair Value Through Profit or Loss (FVTPL) that are directly attributable to the acquisition or issue of the financial asset or financial liability.</td><td rowspan="2">With deal structures becoming increasingly more sophisticated, and complex financial instruments becoming popular for companies to raise capital, to comply with Ind AS 39, companies will require help of technical experts possessing a deep understanding of fair value standards governing valuations and highly specialised technical skills for carrying out fair valuation of these instruments.</td></tr>
<tr><td>Financial Instruments–classification and subsequent measurement of financial assets</td><td>As per AS 13, investments are classified as long-term or current depending on intended holding period on the date the investment. Long-term investments are carried at cost less provision for permanent diminution in value. Current investments are carried at lower of cost and fair value.</td><td>All financial assets are classified as measured at amortised cost or measured at fair value. Subsequent measurement depends on how the financial instrument is classified.</td></tr>
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One of the Valuation Services Group's focus areas is the Financial Reporting Valuation. We provide full range of valuation services for financial reporting purposes in compliance with Ind AS addressing key areas of concern to auditors and regulators. We have several years of experience in providing valuation service to companies following IFRS and US GAAP.

More Sophisticated Considerations

The extensive use of fair value in Ind AS rather than book value (followed under IGAAP) in the preparation of financial statements will lead to better reflection of company's financial health and transparency. However, it will also lead to some volatility in income and equity because of changes in market conditions. Hence, the professional judgment of valuation professionals and knowledge of sophisticated and complex valuation techniques will be crucial in effective application of fair value accounting.

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- Companies Act, 2013 – valuation performed by Registered Valuer

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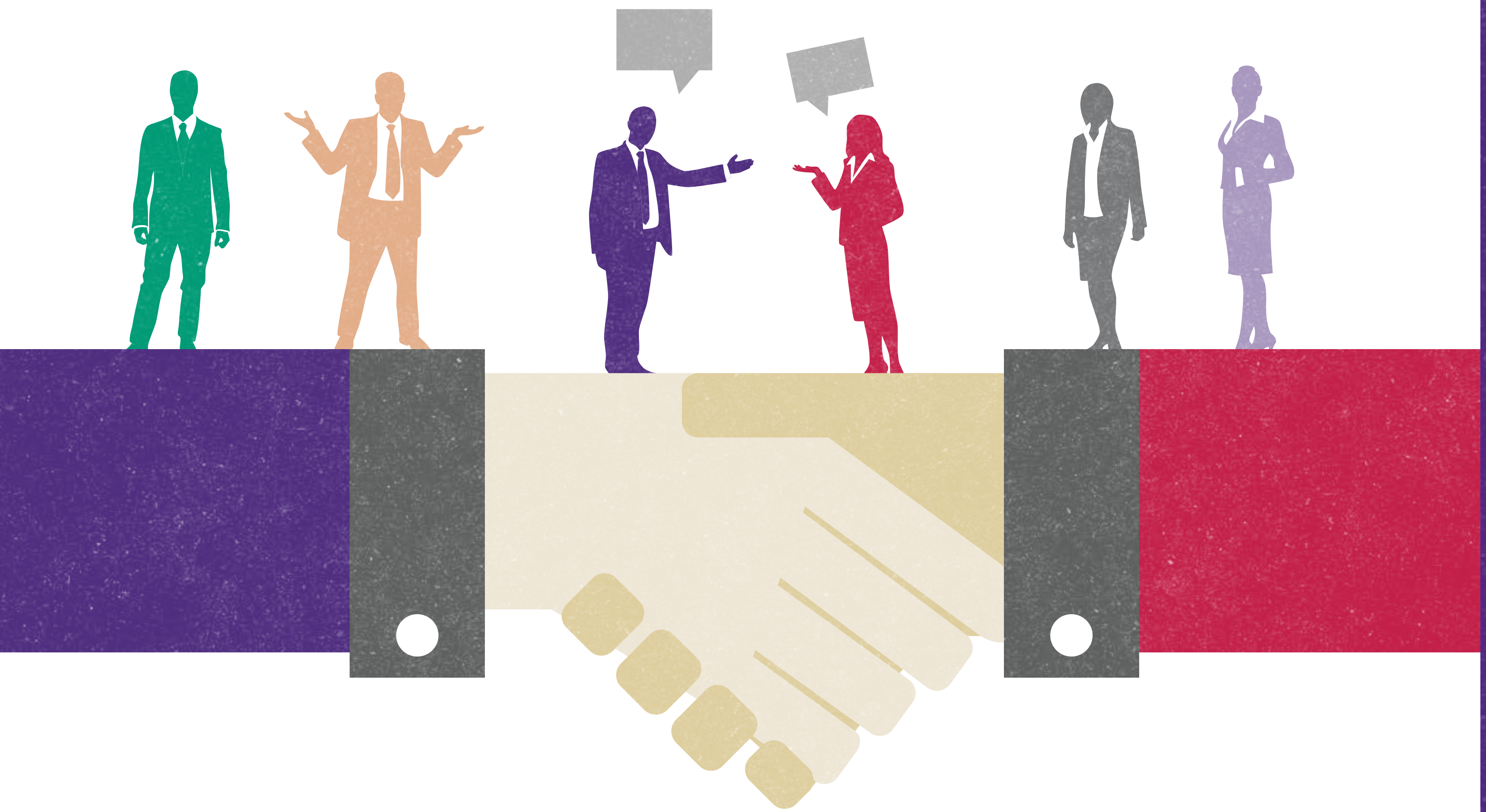

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